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86-793 (2)

No.

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,
vs.
THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, ET AL.,
No. 86-781
Appellees.

KANSAS CITY POWER AND LIGHT COMPANY,
Appellant,
vs.
THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, ET AL.,
No. 86-793
Appellees.

ON APPEAL FROM THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

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QUESTIONS PRESENTED

1. Whether the United States Constitution compels ratepayers to provide Appellants a return on more than the reasonable value of utility plant which is used and required to be used.
2. Whether tne Constitution prohibits consideration of a utility plant's cost efficiency in providing electric service for purposes of determining its reasonable value.
3. Whether the Kansas Corporation Commission's decision allowing a reasonable return on the reasonable value of the used and required to be used plant nonetheless jeopardizes the utilities' financial stability.

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ON APPEAL FROM THE SUPREME COURT OF KANSAS

MOTION TO AFFIRM OR DISMISS

Appellee moves this Court to dismiss the appeal of the Appellants for want of a substantial federal question or, in the alternative, affirm the judgment of the Supreme Court of the State of Kansas on the grounds that the State Corporation Commission of the State of Kansas properly applied the required constitutional standards and achieved a reasonable result.

STATEMENT OF THE CASE

A. Introduction

This matter is an appeal by Kansas City Power and Light Company (KCPL) and the Kansas Gas and Electric Company (KG&E) from orders of the State Corporation Commission of the State of Kansas (KCC) concerning the interim rates associated with Kansas' first nuclear generating station, Wolf Creek. The arguments now raised by Appellants were decided by the Supreme Court of the State of Kansas in Case Nos. 58,914, 58,917 and 58,918, *Kansas Gas and Electric Co. v. Kansas Corporation Commission,* 239 Kan. 483, 720 P.2d 1063 (1986), *reh'g denied,* July 17, 1986. The Kansas Supreme Court affirmed the orders of the Kansas Corporation Commission, without modification, by a 6 to 1 decision. *Id.* (Schroeder, C.J., dissenting)

B. Facts

In 1979, the KCC created a special docket (No. 120-924-U) initiating a generic investigation of the projected costs and related matters of the Wolf Creek Generating Facility. The purpose of the generic investigation was to collect and assimilate data relevant to the anticipated filing of the formal application for rate relief. Five years later, in November 1984, the appellants filed applications requesting changes in its charges for electricity, predicated upon the inclusion of Wolf Creek in rate base. Both appellants amended their applications on January 31, 1985, restarting a 240-day statutory suspension period.

The Wolf Creek rate case represented the largest, most complex, and most publicly commented on rate case in

Kansas history. The Commission traveled to nineteen public hearings across the companies' service territories to hear the testimony of four hundred seventy-five ratepayers. During the rate case hearings, the Commission heard the testimony of one hundred sixty technical witnesses and admitted almost four hundred exhibits. The transcript of the proceedings, mammoth by Kansas standards, covered fifty-eight volumes and seventeen thousand, eight hundred and thirty pages. Briefs were filed by all parties, oral arguments heard, and on September 27, 1985, the KCC issued the "Wolf Creek orders".

The Wolf Creek orders have six interrelated conceptual components. The first three components of the orders deal with the recovery of the costs related to Wolf Creek, while the final three components deal with the return on construction costs. First, Appellants received almost all that they requested in expenses to maintain and operate the plant during its life, and to decommission the plant at the end of its operational life. Next, the Commission determined that $183 million of the construction costs of Wolf Creek were imprudently incurred. The imprudence exclusion equaled roughly ten percent of the total construction costs of Wolf Creek. Third, the KCC allowed the Appellants to recover *all* of the remaining ninety percent of the construction costs of Wolf Creek through annual depreciation expenses over the expected thirty year life of the plant. Thus, with the exception of the prudence disallowance, which is not at issue in this proceeding, the Appellants are allowed the recovery of *all* of the construction costs associated with Wolf Creek.

While the preceding regulatory adjustments dealt with the return or recovery of construction costs associated with Wolf Creek, the final three adjustments deal solely with the return or profit on the rate base. The Commission

first made an excess capacity adjustment. After analyzing the available capacity for each utility, projecting forward five years in determining the peak load responsibility and using a twenty percent reserve margin, the Commission found 327 megawatts of Wolf Creek "not required to be used" by KG&E. Using the same analysis the Commission found that 314 megawatts were "not required to be used" by KCPL. Appellants were not allowed a return *on* the portion of Wolf Creek which was not "used or required to be used." Next, the Commission found that the portion of Wolf Creek which is used and required to be used was an extraordinarily expensive means of providing base load capacity, and could have been provided at a more reasonable cost. After an extensive discussion of the economics of Wolf Creek, the Commission allowed the Appellants a return on the reasonable value of Wolf Creek, expressed in the form of $1,290 per kilowatt. Finally, the Commission allowed the accrual of carrying charges on the physical portion of the plant which was excluded.

In summary, the Commission disallowed ten percent of the construction costs as imprudently incurred costs. The remaining ninety percent of the construction costs are recovered through the use of annual depreciation expense over the expected life of the plant. The Commission allowed a return on the portion of the plant which was "used and required to be used" at the reasonable value of $1,290.00 per kilowatt. The KCC orders contemplated that the physical and economic excess capacity adjustments would be revised periodically and that, as the load forecasts and value of the plant increased, so would the return on ratebase. The Commission also allowed the Appellants to accrue carrying charges on the portion of the plant found to be physical and economic excess capacity.

Finally, it must be pointed out that the Wolf Creek orders on appeal are Interim Rate Orders. Because the rates were necessarily based on estimated costs, they are subject to review in permanent rate proceedings.

ARGUMENTS IN SUPPORT OF MOTION TO DISMISS OR AFFIRM

These consolidated appeals present no substantial federal question and should, therefore, be dismissed. In the alternative, since the Kansas Supreme Court applied appropriate constitutional standards in upholding the Kansas Corporation Commission's orders, its decision should be affirmed.

The KCC, in these cases, carefully weighed competing interests to determine reasonable rates based on the reasonable value of used and required to be used utility plant. The methods and procedures followed in making such determinations were reasonable, appropriate, and consequently, well within constitutional boundaries. Further, the rates that resulted have not and will not seriously jeopardize the financial stability of the utilities.

1. THE COMMISSION'S DECISIONS FOLLOWED CONSTITUTIONAL STANDARDS BY BALANCING COMPETING INTERESTS IN DETERMINING REASONABLE RATES BASED ON RETURN OF 90% OF WOLF CREEK COSTS AND RETURN ON THE REASONABLE VALUE OF USED AND REQUIRED TO BE USED PLANT.

The constitutional considerations involved in the making of rates have been well established by previous de-

cisions of this court. Ratemaking authorities are not tied to any particular formula or combination of formulae and are free to make pragmatic adjustments which may be called for by particular circumstances. The ratemaking process involves a balancing of investor and consumer interests. Neither interest is paramount and a regulated utility does not have a consitutional guarantee of net revenues. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (hereinafter *Hope*). Rather, utilities are allowed the opportunity to earn a return on the value of property utilized for the public convenience, at the time such property is utilized, and when the utility has exercised "prudent," "efficient" or "economical" management. *Blue Field Waterworks and Improvement Company v. Public Service Commission,* 262 U.S. 679, 692-693 (1923); *Wilcox v. Consolidated Gas Company,* 212 U.S. 19, 41 (1909). Courts may not set aside a rate selected by a regulatory authority if it falls within a zone of reasonableness, *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), and if it produces no arbitrary result. *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942).

In the instant case, the Kansas Supreme Court has correctly found that the KCC's decisions accomplished a balancing of interests to establish rates within a zone of reasonableness using recognized methodology. This court should also conclude and thereby end its inquiry.

The decisions in these cases were based on a ratemaking framework which is well established and accepted. Like other state regulatory commissions, the KCC makes utility rates by use of a formula which provides for a reasonable rate of return *on* the reasonable value of "used and useful" utility property after recovery of all reasonable operating expenses. Return *of* the cost of utility property

is also provided for through depreciation expense. Not at issue in these appeals is the fact that the KCC does not, and did not in these cases, allow return of, or return on, plant costs which were imprudently incurred.

In these cases, the KCC found that about one-half of the new Wolf Creek plant was not physically needed to serve ratepayers and that its reasonable value was less than its original cost. In balancing the competing interests, however, the KCC did not apply the ratemaking formula as strictly as possible. Although no return was allowed on the excess capacity portions of the plant, a return of all the prudent original costs, or ninety percent of the total costs, was permitted. This was granted despite the fact that Kansas law would have permitted a disallowance of both the return on and return of the physical excess capacity costs. It is also noteworthy that the determination of the physical need for the plant was unusually lenient in that the KCC allowed for five years of future load growth as a reasonable planning horizon. As that projected load increases, more of Wolf Creek will be deemed used and required to be used and eligible for a rate of return. Likewise, if the value of the plant increases, that fact will also be reflected in rates.

The KCC's decision to allow for return of excess costs, but exclude return on these costs was a reasonable balancing of the competing interests. In doing so, the KCC considered all the relevant evidence in the voluminous record to arrive at its "risk sharing" approach.

A basic conclusion reached from the evidence was that the valuation of Wolf Creek should reflect its relative cost inefficiencies. Evidence presented to the KCC by expert witnesses for its staff and an intervenor clearly showed that the total life-cycle costs of the plant to ratepayers was

much greater than reasonable alternatives would have been.[1] These results were basically due to the fact that Wolf Creek's lower fuel costs would not offset its much higher capital costs relative to alternative capacity such as a coal-fired plant. Although it agreed with the witnesses' overall conclusion that Wolf Creek was an excessively expensive source of electricity, the KCC decided that a life-cycle evaluation required too many long-term projections to be appropriate for a precise valuation of the plant. The valuation method chosen instead took a more objective approach by reflecting current cost inefficiencies of the plant.

As suggested by the *Hope* case, in arriving at its valuation, the KCC looked at the circumstances to determine what "pragmatic adjustments" were necessary. The Commission considered the companies' decisions to build and continue construction of Wolf Creek, the economic costs to ratepayers and the companies of resulting rates and the risks assumed by the companies and their shareholders. The KCC found the evidence compelling that the companies' decisions to continue the project, especially after 1981, were not based on adequate analysis and review and appear to have stemmed from institutional inertia. Furthermore, by the end of 1981, the companies knew or should have known that the increased capital costs of Wolf Creek subjected its overall economics to serious question. This probable result was confirmed by the KCC finding that

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1. KCPL asserts that the KCC could not conclude in its Order that Wolf Creek would not produce a net benefit to customers over its life. (KCPL Jurisdictional Statement at 18). That is simply incorrect. The language apparently referred to by KCPL (A-99f) only notes that favorable rates may result from Wolf Creek sometime in the future. This, however, is far different than concluding that future favorable rates would totally offset past unfavorable rates. The KCC found this offset would not occur.

inclusion of Wolf Creek in rate base would result in rates that were significantly higher than other Kansas utilities, above the national average into the 1990's, and unreasonably high for ratepayers to pay. By not closely scrutinizing the desirability of continued construction after 1981, the companies also assumed the risk that Wolf Creek would not be a cost efficient source of electricity. This was especially true in view of declining growth in forecast load demands known to the Company from 1979 on, a reduction in the ownership share of a third owner and inability to sell participation power to other utilities. The deliberate and considered assumption of risks by the companies was particularly highlighted by the two KG&E shareholder votes in 1980 and 1981, which defeated resolutions to cancel the project in light of escalating construction costs and doubts about the need for capacity.

In view of all the circumstances, it was quite appropriate that the Commission use the capital costs of a coal plant providing the same capacity as Wolf Creek as its valuation benchmark. Capital costs above that were part of the risks that the companies took in deciding to continue construction.[2] The benchmark of $1,290 per KW must be viewed as especially appropriate in view of the fact that the KCC, in approving of a third party's purchase of a share of Wolf Creek in 1980, after protracted hearings that thoroughly aired many of the problems and diseconomies at the Wolf Creek venture, attempted to place a ceiling on the

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2. The $1,290 per KW valuation included $90 per KW to reflect the generating cost differences beetween Wolf Creek and a coal plant. KCPL mistakenly suggests that this represents only fuel savings and that a return on the total life-cycle savings should be paid each year. (KCPL Jurisdictional Statement at 18). This is clearly erroneous since the annual return provided in rates should be on the annual generating cost savings which have been translated into capital cost. This position is also strikingly at odds with KCPL's strenuous objection to a life-cycle analysis.

purchase price equivalent to $1,300 per KW as the reasonable value of the plant. *See*, Order Denying Rehearing (Appellants' Appendix, 15d-16d). However, in the instant case the KCC concluded that not all of the consequences flowing from the cost inefficiencies of Wolf Creek should be borne by the companies. As the Commission explained in its November 15, 1985, Order (Appellants' Appendix, 13d-14d):

> We found in our September order that risks were appropriately shared by not allowing a return on both the physical and economic excess portions of Wolf Creek but allowing a return of these costs. K.S.A. 66-128c, of course, clearly allows the Commission to "exclude all or a portion" of excess capacity costs of a utility so that not only the return on those costs but also the return of those costs may be disallowed. Although such an alternative was available, the Commission believes that the approach taken is more appropriate. As reflected in the prior order, the Commission considered the concerns for fuel diversity which prompted construction of Wolf Creek in determining that return of the investment was appropriate. This, however, was premised on no return on that portion of Wolf Creek which exceeded a reasonable valuation since we believe that the risks to be shared involve both the amount and cost of capacity resulting from the generation facility.

Thus, the Commission used the accepted ratemaking formula and determined the reasonable value of used and required to be used property. It then balanced competing interests by providing for return of, but no return on, excess costs. Each of these components is reasonable and supported by case law.

Commissions and courts across the country have recognized that application of a "used and useful" test to utility property is valid and appropriate. Thus, for example, the Pennsylvania Commission's disallowance of a return on excess capacity was upheld in *Philadelphia Electric Co. v. Pennsylvania Public Utility Comm'n,* 433 A.2d 620 (Pa. 1981). Similarly, the Iowa Supreme Court found no abuse in the commission's conclusion that ratepayers "should share with the utility's investors the cost of investment in excess capacity" and the risks of the capacity planning process. *Iowa Planners Network v. Iowa State Commerce Commission,* 373 N.W.2d 106, 110 (Iowa 1985). *See generally,* Colton, *Excess Capacity: Who Gets the Charge From the Power Plants?* 34 Hastings L.J. 1133, 1146-49 (1983). As noted by KCPL, this court has dismissed, for want of a substantial federal question, utility appeals dealing with recovery of costs of plant that is not used and useful because of abandonment or inoperability. (KCPL Jurisdictional Statement at footnotes 25, 26).

Although this court may not have explicitly approved the use of an efficiency standard for valuation purposes, it has recognized that there is no single formula for valuation and that all relevant evidence should be considered. *FPC v. Natural Gas Pipeline Co.,* 315 U.S. 575, 585 (1942). Furthermore, the court has apparently recognized that ratemaking valuation is not required "to insure value or to restore value that have been lost by the operation of economic forces." *Market Street Railway Co. v. Railroad Comm'n of California,* 324 U.S. 548, 566-67 (1945). Although that case included a tramway service which had little market value, the principle applies as well in the instant case where economic forces have changed the value of Wolf Creek from its book costs. At least one state court has explicitly approved the valuation of utility plant

at the cost of a more efficient alternative. *Utilities Comm. v. Power Co.*, 285 N.C. 377, 206 S.E.2d 269 (1974); *Utilities Comm. v. Mebanc Home Telephone Co.*, 298 N.C. 162, 257 S.E.2d 623 (1979).

The concept of "risk-sharing" is also now accepted by courts and industry commentators. *E.g., Iowa Planners Network v. Iowa State Commerce Commission*, 373 N.W.2d 106 (Iowa 1985); *Philadelphia Electric Co. v. Pennsylvania Public Utility Comm'n*, 433 A.2d 620 (Pa. Comwlth 1981); Smartt, "The Social Compact and the Sharing of Risk," Public Utilities Fortnightly, July 10, 1986. Although the application of the concept to failures in utility capacity planning and construction may be relatively recent, the principle of sharing economic consequences of utility investment has been previously recognized. *Democratic Cert. Comm. of D.C. v. Washington MAT Com.*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974) (sharing of gains of sale of utility asset).

It is consequently readily apparent that the KCC's approach in these cases was reasonable, equitable and lawful. Appellants nonetheless argue that these cases are of national significance because of their chilling effect on the construction of utility plant. It is true that regulatory commissions have been faced recently with very troublesome problems arising from construction of generating units. However, there is no need and it would be undesirable for this court to attempt to fashion any more specific constitutional guidelines than already exist. Each regulatory commission should continue to have the flexibility to make the pragmatic adjustments appropriate to the circumstances, as they have traditionally done. Furthermore, there is certainly no national crisis portended by the instant cases. The only "chilling" effect of the

KCC decisions is to encourage careful and prudent utility planning for efficient provision of electrical power. Such a consequence does not require this court's attention. Moreover, radical departure from the flexible and discretionary guidelines that state regulators have traditionally relied on, particularly under these facts, would have an equal, if not more drastic chilling effect on the efforts of state regulators to fashion fair, balanced and workable solutions to the economic and capacity problems created by utility over-construction.

2. THE COMMISSION'S DETERMINATION OF WOLF CREEK'S REASONABLE VALUE RESULTED FROM A CONSTITUTIONAL APPLICATION OF A CONSISTENT STANDARD AFTER PROPER NOTICE AND AN OPPORTUNITY TO BE HEARD.

Appellant KG&E suggests that the valuation of Wolf Creek is inconsistent with the method used to value other KG&E assets, and thus violates its equal protection rights under the fourteenth amendment. (KG&E's Jurisdictional Statement, p. 16-17). This claim is without merit. Appellants' contention fails to recognize the fact that the Commission applied an overall standard of valuation consistent with the utilities' statutorily imposed duty to provide efficient service.

As Appellant KG&E concedes, the appropriate standard of review for economic regulation of this type is the lenient "rational basis" standard. *Exxon Corp. v. Eagerton,* 462 U.S. 176 (1983); *New Orleans v. Duke,* 427 U.S. 297 (1976). Thus, Appellee must merely show that a rational basis eixsts for the valuation of Wolf Creek at a different level from the value of Appellant KG&E's other assets. Thus burden is easily met.

Simply stated, the Commission has consistently applied the same standard of efficiency to all of KG&E's property. In explaining that its other plant was valued at original book cost, KG&E fails to distinguish between the method or standard employed and the result gained from the application of that standard. It is beyond dispute that KG&E has a duty to provide reasonably efficient service at reasonable rates. Indeed, like all utilities, KG&E is obligated to incur only those costs which are reasonable and necessary to provide service in the most efficient and least costly manner. In this case the Commission found that a portion of the Wolf Creek costs were inefficient, excessive, and elected not to pass those excessive costs through to ratepayers. If evidence had been presented of other excessively expensive assets during the Wolf Creek hearings, the Commission would have been compelled to reflect the cost inefficiencies in the value of those assets. However, since no such evidence was presented of the value of other assets during the Wolf Creek rate hearings, KG&E's claim of inconsistent valuation lacks a factual foundation for support.

The standard of "efficient" service is rationally related to the legitimate state interests of (1) protecting ratepayers from excessively expensive generation facilities and (2) sending the proper economic signals to utilities regarding the construction of inefficient plant. Although the application of this standard to Wolf Creek resulted in a value that was different from other asset values in KG&E's ratebase, this result was justified by the evidence presented. (Appellants' Appendix, 69c-100c).

There should be no question that this Commission may reflect Wolf Creek at a value other than original cost. Kansas law clearly holds that a utility has no vested right

in a particular formula or combination of formulae. *Southwestern Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, 386 P.2d 515 (1963). The right of this Commission to use its broad discretion to determine the reasonable value of plant reflects the need for "pragmatic adjustments which may be called for by particular circumstances." *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942). For instance, in *Pennsylvania Public Utility Comm'n v. Pennsylvania Gas & Water*, 492 Pa. 326, 424 A.2d 1213 (1980), the court held that the Pennsylvania Commission could depart from the general "fair value" standard to an "original cost" standard. Although the property in *Penn* was received at no cost, due to state contributions, the court found it just and reasonable to not require consideration of "reproduction costs", as was necessary for other assets. Clearly, this Court in *Market Street Railway Co. v. Railroad Commission of California*, 324 U.S. 548 (1945) recognized the mercurial nature of value and the relationship between the operation of economic forces and value for regulatory purposes.

Indeed, recent cases have found that comparisons to a substitute plant rather than the reproduction cost of existing plant could limit the value of an existing system. *North Carolina v. Duke Power Co.*, 285 N.C. 377, 206 S.E. 2d 269 (1974); *see also Citizens Action Coalition of Indiana, et al. v. Northern Indiana Public Serv. Co., et al.*, 485 N.E.2d 610 (Ind. 1985). In addition, the use of a surrogate or hypothetical capital structure for comparison is well recognized in Kansas law. *Sekan Electric Coop. Ass'n v. Kansas Corp. Comm'n*, 4 Kan. App. 2d 477, 604 P.2d 188 (1980). Clearly, the KCC's valuation of Wolf Creek was neither novel nor arbitrary, but rather a reasonable application of a well recognized standard, and well within constitutional parameters.

KG&E also suggests that since the Commission did not use a valuation method that was suggested by any of the parties, KG&E's right to procedural Due Process was violated. KG&E's contention is legally without merit and factually false. The valuation method actually used by the Commission was a variation of an analysis presented by the Appellants. In essence, the valuation is a combination of the life-cycle analysis proposed by Dr. Rosen (a staff witness) and the bus bar cost analysis used by the utilities.

From a factual standpoint, the Commission stated: "In determining the proper valuation of capital costs, the Commission has concluded that the proper value is what a coal-fired plant meeting the applicant's needs would have cost *as suggested by Intervenor Mary Margaret Rogers.* (Appellants' Appendix, 104c, Paragraph 9, emphasis added). Thus, KG&E's protestations that "KG&E was completely surprised by the *KCC's* creation of such a valuation method" (KG&E jurisdictional statement, p. 18, emphasis added) are shown as factually false. KG&E had every opportunity, and indeed did present considerable evidence concerning the value of Wolf Creek. In fact, all parties presented evidence on the crucial issue of value. The result of the Commission using a method other than the one proposed by KG&E hardly rises to the level of a procedural Due Process claim.

KG&E's failure to distinguish between its Due Process rights as to the issue of valuation and the method the Commission used to analyze the valuation issue is not unique. In *R.R. Comm'n v. Pacific Gas Co.*, 302 U.S. 388 (1938), this Court stated:

> The complaint is not of the absence of these rudiments of fair play but of the method by which the Com-

> mission arrived at its results. As to this, a fundamental distinction must be observed. While a fair and open hearing must be recorded as an inexorable safeguard, we do not sit as board of revision but to enforce constitutional rights. *San Diego Land & Town Co. v. Jaspar,* 189 U.S. 439, 446. When the ratemaking agency of the State gives a fair hearing, receives and considers the competent evidence that is offered, affords opportunity through evidence and argument to challenge the result, and makes its determination upon evidence and not arbitrarily. The requirements of procedural due process are met, and the question that remains for this Court, or a lower federal court, is not as to the mere correctness of the method and reasoning adopted by the regulatory agency, but whether the rates it fixes will result in confiscation. (302 U.S. at 393-4).

The Commission received, considered, analyzed in the order and rejected KG&E's value of Wolf Creek. KG&E presented its direct evidence on valuation in the rate case, and argued against the valuation method ultimately chosen by the Commission during the rehearing proceeding. Clearly, KG&E's Due Process rights have been satisfied. KG&E's right to an opportunity to be heard in regard to the issue of valuation has been met. KG&E's claim to the contrary is without merit.

There is no doubt that under the fourteenth amendment KG&E has the procedural rights to notice and an opportunity to be heard. *Morgan v. United States,* 304 U.S. 1 (1938). By an order dated March 29, 1985, the Commission defined six Wolf Creek related issues that were to be heard on a common record. The sixth issue was: "whether any portion of the cost of acquisition,

construction or operation of Wolf Creek were incurred due to a lack of efficiency or prudence, included, but not limited to, consideration of those factors to be considered pursuant to K.S.A. 1984 Supp. 66-128g(a)". (Appellant's Appendix, p. 10c). Clearly, KG&E received specific notice that the value of Wolf Creek was a controverted issue. Indeed, in its jurisdictional statement KG&E states, "the valuation of Wolf Creek was the most important issue before the KCC". (KG&E jurisdictional statement, p. 18). KG&E's contention that it did not have adequate notice, when viewed in light of the specific notice in the Commission's March 29, 1985 order and the admitted general notice KG&E had that valuation was a crucial issue before the KCC, is simply incorrect.

3. THE END RESULT OF THE COMMISSION'S DECISION PROVIDES FOR REASONABLE NON-CONFISCATORY RATES AND DOES NOT SERIOUSLY JEOPARDIZE THE UTILITIES' FINANCIAL INTEGRITY.

As discussed above, the KCC's decisions in these cases were the result of a careful balancing of competing interests within a reasonable ratemaking framework following appropriate procedure. Appellants nonetheless misconstrue *Hope* and its progeny to suggest that the KCC's decisions result in confiscation and that the Kansas Supreme Court has misapplied the *Hope* standard. Even assuming *arguendo* that Appellants are correctly interpreting *Hope*, no serious threat to their financial integrity exists which requires remedy.

Even a summary reading of the opinion of the Kansas Supreme Court reveals that the court had a complete understanding of the requirements of *Hope* and its progeny

and meticulously applied the evaluation and balancing required by *Hope*.

> In *Hope*, the United States Supreme Court addressed the considerations to be taken into account by the Federal Power Commission in setting 'just and reasonable' rates for natural gas companies, as required by § 4(a) of the Natural Gas Act of 1939, 15 U.S.C. § 717c(a) (1982). In supplying the standard requiring 'just and reasonable' rates, the *Hope* court emphasized that the focus of inquiry is properly upon the end result or 'total effect' of the rate order, rather than on the rate setting method employed. The court described the rate setting process as a balancing process involving the weighing of certain enumerated interests of the consumer and of the investor. The court stated that the ratemaking process involves a balancing of the investor and the consumer interests and that public utility regulation does not ensure that the business shall produce net revenues.

Kansas Gas & Electric Co. v. Kansas Corp. Comm'n, 239 Kan. 483, 490, 720 P.2d 1063, 1071 (1986) (Appellants' Appendix, p. A-10a). The Kansas Supreme Court acknowledged the interpretation of *Hope* in *Permian Basin Area Rate Cases*, 390 U.S. 747, *reh'g denied*, 392 U.S. 917 (1968), wherein this court held that a rate order selected by a regulatory commission within the "broad zone of reasonableness" cannot properly be attacked as confiscatory. The Kansas court concluded, "All of these cases clearly support the general principle that a state regulatory agency, in setting a rate for a public utility, must have as its goal a rate fixed within the 'zone of reasonableness' after an application of a balancing test in which the interests of all concerned parties are considered." (Appellants' Appendix, p. A-12a-A-13a).

The Kansas Court properly understood and properly applied the balancing test required by *Hope*. The Kansas court's characterization of the issue in *Hope*, cited by Appellant Kansas City Power & Light, was evidently borrowed from *Pennsylvania Electric Co. v. Pennsylvania Public Utility Comm'n*, 509 Pa. 324, 502 A.2d 130 (Pa. 1985), wherein the Pennsylvania Supreme Court said:

> The issue presented in this appeal is a narrow one, namely whether the decision of the United States Supreme Court in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944) established a requirement, of constitutional dimension, that utliity rates set by regulatory authorities be set at sufficiently high levels as to guarantee, irrespective of countervailing consumer interests, the continued financial integrity of the utilities concerned.

The similar characterization of the issue in *Hope* is easily understandable in light of the similarity of Appellants' arguments before the Kansas Supreme Court. In both cases, Appellants contended that continued financial integrity of their businesses was required by the *Hope* decision. The Kansas Supreme Court agreed with the Pennsylvania Supreme Court's interpretation of *Hope*, holding that:

> . . . the decisions of the United States Supreme Court did not establish, as a constitutional requirement, that the end result of a ratemaking body's adjudication must be the setting of rates at a level that will, in any given case, guarantee the continued financial integrity of the utility. Rather, *Hope* requires only that the regulatory authority balance competing consumer and investor interests to determine just and reasonable rates providing a return on used and useful property.

The essence of Appellants' arguments in these cases is that regulatory authorities may not reasonably apply accepted ratemaking principles if doing so would result in low earnings for the utility. This is an erroneous interpretation of constitutional standards which was directly addressed by the court in *Pennsylvania Electric*:

> The "used and useful" principle is soundly based, for it serves to protect consumers from exploitation, and it comports with the view that, in fairness, consumers should not be required to buoy up failing utility companies by being required to, in effect, provide public subsidies for utility properties that are not useful in the public service. If the Hope decision were to be interpreted as providing constitutional guarantees for the achievement of investor interest, the "used and useful" principle would have to yield, at least in exceptional situations where the financial integrity of a utility is imperiled, but we do not perceive from Hope that investor interests are to be accorded such a guaranteed status.

Ibid., 502 A.2d at 134. *See also, Citizens Action v. Northern Indiana Public*, 485 N.E.2d 610, 614 (Ind. 1985), *cert. denied*, 106 S.Ct. 2240 (1986).

The Pennsylvania Supreme Court found support for its conclusion in noting that similar results from similar facts had been reached in *In re: Jersey Central Power & Light Co.*, No. A-162-81T2 (July 28, 1983), *cert. denied*, 95 N.J. 217, 470 A.2d 433 (1983), which had been subsequently dismissed for want of a substantial federal question, *Jersey Central Power & Light Co. v. Board of Public Utilities of New Jersey*, 466 U.S. 947 (1984). The appeal of the *Pennsylvania Electric* decision was also subsequently dismissed by this court. *Pennsylvania Electric Co. v. Pennsylvania Public Utility Commission*, 509 Pa. 324,

502 A.2d 130 (Pa. 1985), *appeal dismissed sub nom. Metropolitan Edison Co. v. Pennsylvania Public Utilities Commission,* 106 S.Ct. 2239 (1986).

> Unlike the grant or denial of certiorari, which expresses no intimation as to the merits of a case, a dismissal for want of a substantial federal question is, like a summary affirmance, a decision on the merits. *Ohio ex rel Eaton v. Price,* 360 U.S. 246, 247, 79 S.Ct. 978 (1959) (other citation omitted). The Supreme Court of the United States has, therefore, through dismissal of the *Jersey Central* appeal, stated implicitly its approval of the holding in that case, and our holding in the instant case is identical to that which was approved in *Jersey Central.*

Ibid., 502 A.2d at 136.

This Court has thus agreed that reasoned regulatory principles such as "used and useful" do not yield to the financial interests of utilities. Appellants have attempted to distinguish the instant cases from those dismissed by this Court by noting that those cases involved cancelled or inoperable utility plants. Such a distinction has no discernible legal basis. The constitution does not afford different guarantees based on the regulatory reasons for finding a utility plant not used and useful. A contrary conclusion would encourage utility companies to initiate and complete construction of utility plant, even if construction of the plant was cost inefficient because it was too expensive or otherwise could not provide efficient service. Such a perverse incentive cannot be found to have been the end result contemplated by *Hope.*

Even if Appellants' arguments were correct, however, there is no serious threat to the utilities' financial stability. Appellee has discovered only one recent case

which found that the end result test of *Hope* may have been violated. In *Jersey Central Power and Light Co. v. Federal Energy Regulatory Commission,* 768 F.2d 1500 (D.C. Cir. 1985), the court reversed an earlier decision and remanded to FERC for a full evidentiary hearing on whether the decision to disallow costs of a cancelled nuclear plant violated *Hope*. That decision was subsequently vacated by the full court, but even affording full consideration that expansive view of *Hope's* financial guarantees, there is no constitutional infirmity with the KCC's decisions.

The decision in *Jersey Central* reflected concern with the disallowance of cancelled plant costs in the face of the utility's assertions that for four years it had (1) been unable to pay any dividends on its common stock; (2) had been repeatedly on the edge of being forced into bankruptcy; (3) had no access to the long-term capital markets; and (4) had been wholly dependent upon a short-term revolving credit agreement which was subject to termination at a moment's notice. *Ibid.*, 768 F.2d at 1502.

The Appellants in these cases have not and cannot argue that they have been or will be in financial distress even approaching that of Jersey Central Power and Light, much less those of other troubled utilities with cancelled or abandoned generating plants. Although their returns have been restricted, as permitted by *Hope*, there is no realistic concern that Appellants have lost financial integrity. *See* Cleaves, *Constitutional Protection for the Utility Investor: The Confiscation Doctrine After Cleveland Electric Illuminating Co. v. Public Utilities Commission of Ohio*, 12 B.C. Environment Affairs L.Rev., 527 (1985). This is especially true in light of the fact that the KCC orders envision greater returns on Wolf Creek as it becomes more used and useful and as its value relative

to coal plants increases. In such circumstances it is especially important that the reasonableness of rates be tested by actual experience rather than speculation. *Brush Electric Co. v. Galveston,* 262 U.S. 433 (1923); *See William v. Consolidated Gas Co.,* 212 U.S. 19, 41 (1908). There is no actual experience suggesting that the utilities' stability is in jeopardy to the extent that the KCC orders were outside the zone of reasonableness in violation of *Hope.*

CONCLUSION

No substantial Federal question exists in these considered cases since the Kansas Commission decisions resulted in fair, reasonable, and lawful rates. The Kansas Supreme Court applied the correct constitutional standards in upholding the KCC's decisions. This Court should, therefore, grant this Motion to Dismiss or Affirm.

Respectfully submitted,

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